



Directorate of
Intelligence

Secret

International Economic & Energy Weekly

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Economic & Energy
Weekly**

25X1

27 May 1983

iii	Synopsis	25X1
1	Perspective—What Syria Wants	25X1
3	Briefs Energy International Trade, Technology, and Finance National Developments	25X1
13	Lebanon: Economic Consequences of a Negotiated Settlement	25X1
19	Jordan: Coping with Slower Economic Growth	25X1
25	Public Services in Cairo: Potential for Unrest	25X1 25X1
29	North Yemen: In a Financial Bind	25X1 25X1
35	USSR and Eastern Europe: Early Grain Crop Prospects	25X1 25X1

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27 May 1983

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**International
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Synopsis

Perspective—*What Syria Wants*

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A combination of political assurances by the United States and Lebanon and financial compensation—presumably from Saudi Arabia—will probably be required to get Syrian troops out of Lebanon.

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Lebanon: Economic Consequences of a Negotiated Settlement

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The vitality of Lebanon's predominately trade- and service-based economy depends heavily upon Beirut's relations with its Arab neighbors. Arab reaction to the Lebanese-Israeli accord on foreign troop withdrawals could have a significant impact on these vital links.

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Jordan: Coping with Slower Economic Growth

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The rapid growth in Jordan's key sources of foreign exchange is grinding to a virtual halt, reinforcing King Hussein's reluctance to take foreign policy measures—such as negotiating with Israel—not supported by Saudi Arabia and his other Arab financial backers.

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Public Services in Cairo: Potential for Unrest

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Decades of rapid population growth, inadequate maintenance, and insufficient investment have produced a public services crisis of major proportions in Cairo. The problems caused by unreliable or inadequate water, electrical, waste disposal, and transportation systems are constant sources of frustration to Cairenes, impede commerce and investment, and could ultimately spark serious outbreaks of domestic unrest.

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North Yemen: In a Financial Bind

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North Yemen has been living beyond its means for several years, as evidenced in recurring budget and balance-of-payments deficits. Virtually any economic retrenchment or measures to raise additional revenue, however, risk social discontent and erosion of the regime's already narrow political base.

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USSR and Eastern Europe: Early Grain Crop Prospects

Both the Soviet Union and Eastern Europe appear headed for good grain crops this year. Continued favorable weather could result in a 220-million-ton harvest in the USSR, while the East European crop could reach 96-100 million tons—only slightly below last year's record. Neither region, however, has much chance of reaching planned targets of 238 million tons for the USSR and 112 million tons for Eastern Europe.

25X1

Secret
27 May 1983

Secret

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Economic & Energy
Weekly** []

25X1

27 May 1983

25X1

Perspective***What Syria Wants*** []

A combination of political assurances by the United States and Lebanon and financial compensation—presumably from Saudi Arabia—will probably be required to get Syrian troops out of Lebanon. While financial incentives alone will not entice Syria to withdraw, President Hafiz al-Assad will certainly demand recompense if and when he decides it is in Syria's best interest to withdraw. Meanwhile, Assad's pretensions to Arab leadership suggest that Damascus will continue to vigorously lobby for moderate Arab support of its point of view. []

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Despite Syria's dependence on Arab financial assistance—about \$2 billion annually over the past several years—Damascus continues to cut a politically independent path. Assad knows from past experience that the Arabs—especially the Saudis who provided \$1.2 billion last year—are much more likely to pony up additional funds to try and sway him than cut off aid. 25X6

[] Soviet and Iranian military and economic support further weakens Arab ability to influence Assad on basic security issues. Soviet weapons deliveries are unlikely to be affected by near-term Syrian inability to pay, and Iran already supplies Syria with \$1.4 billion of oil yearly on easy terms in exchange for Assad's support against Iraq. []

None of the other moderate Arab states have leverage with Damascus that could produce an about-face. Jordan's relations with Syria remain strained despite recent efforts by both countries to improve them. Egypt's support of the Lebanese-Israeli agreement carries no weight with the Syrians. Relations with Egypt have been poor since Sadat's visit to Jerusalem. [] 25X1

Assad will undoubtedly demand strong political assurances from Lebanon and the United States to withdraw from Lebanese territory. He will require assurances that Syria's security interests in Lebanon will not be jeopardized and specifically will probably demand the same security arrangements garnered by the Israelis. Such arrangements may have to include a Lebanese commitment to grant special customs treatment to Syria and assurances that Lebanon will not agree to full normalization of relations with Israel. Assad is also likely to press for a commitment from the United States to move forward on negotiations toward Syria's recovery of the Golan Heights. []

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A Syrian decision not to pull out would set the stage for de facto partition of Lebanon, with the Israelis probably withdrawing south to the Awali River. Under these circumstances the Gemayel government would continue to function as long as serious factional violence did not erupt around the Beirut area, and reconstruction of the Lebanese economy would probably be able to proceed on a limited basis. Industry in the northern region around Tripoli—controlled by Syria—and agriculture in the Israeli-held south would probably continue to be depressed, however. An escalation of factional strife would, of course, postpone economic reconstruction indefinitely.

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27 May 1983

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Briefs**Energy***Spot Oil Market Trends*

Spot crude oil prices have softened in recent weeks, reversing an April rebound when many prices reached near official levels. Arab Light is now selling at \$28.50 per barrel, \$0.50 under its official price of \$29.00. Nigeria's Bonny Light is selling at \$29.80 per barrel versus its official price of \$30.00. Spot prices have probably weakened in response to declining spot product prices, increased OPEC production, and rumors of an increase in Soviet spot product sales in Western Europe. Spot crude oil prices probably will continue to fluctuate in coming weeks as buyers attempt to gain a clearer reading of consumption trends, inventory requirements, and OPEC production intentions.

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Nigerian Oil Production Climbs

Official Nigerian oil production figures confirm an earlier US Embassy estimate that May production has jumped to about 1.7 million b/d—up over 500,000 b/d from April. [] an aggressive marketing drive by the Nigerian National Petroleum Corporation has led to a sharp increase in direct sales. Production at this level, however, violates Nigeria's OPEC-mandated ceiling by 400,000 b/d and could strain OPEC's tenuous production and pricing accord. Lagos has already drawn fire from the OPEC Monitoring Committee for exceeding its quota. []

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Soviet-Norwegian Dispute Over Oil-Drilling Rights

US Embassy sources report that a Soviet ship has begun oil-drilling operations in an area estimated to be 1.5 nautical miles inside the disputed Soviet-Norwegian area of the Barents Sea continental shelf. Because Norway considers its equidistant maritime boundary to contain at least a 2-mile error, it is not contesting the current Soviet operations, although the Norwegian Coast Guard is closely monitoring activities in the area. If the Soviets move farther into the disputed area thereby threatening the delicate balance between the two countries, Norwegian authorities reportedly would consider similar drilling activities in the region. []

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Norway maintains that the continental shelf boundary should be a median line equidistant between its mainland and island territories and those of the USSR. The Soviets continue to claim a boundary line north to the Pole from its territory which encloses everything to its east in an Arctic "sector" claim. This places some 150,000 sq km of the Barents Sea in dispute. Negotiations to resolve this issue have been in abeyance since 1981. The current Soviet actions tacitly reject Norway's suggestion to forgo any activity that would prejudice future negotiations on the disputed area, although Norway believes that the Soviets are showing some restraint in returning to an area explored in 1982 rather than drilling farther into the disputed area. []

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Secret**Zimbabwean
Government
To Control Fuel
Procurement**

The government has announced it will create a national oil company to handle fuel imports now handled by a private consortium. A major objective of the new parastatal is to build a 90-day fuel reserve, something the private companies have found uneconomical. Zimbabwe faced a severe fuel crisis earlier this year when it was caught without contingency reserves following the sabotage at the Mozambican end of the Beira-Mutare pipeline in December 1982. Although the private oil companies had encouraged Harare to take over the import function, the plan to increase reserves means that the government will have to acquire storage facilities from the firms. Details are yet to be worked out, but it is unlikely the government will nationalize the private depots without fair compensation to the oil companies. Harare's long-term plan is to take over distribution and retailing operations as well.

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International Trade, Technology, and Finance**Debtor Country Trade
Balances Improve**

Trade balances for many key debtor countries improved markedly in 1982 primarily because of substantial reduction in imports in the second half of the year. For 12 key debtors, imports fell 19 percent; Mexico, Argentina, Chile, and Nigeria reported a drop of 35 percent or more. Brazilian and Philippine

Key Debtor Countries: Trade Balances ^a*Million US \$*

	1980	1981	1982
Argentina	-1,360	710	2,620 ^b
Brazil	-2,830	1,200	780
Chile	330	-1,440	830
Costa Rica	-340	-60	110
Ivory Coast	580	480	510 ^b
Mexico	-2,980	-3,550	7,720
Nigeria	12,230	2,760	5,870 ^b
Peru	1,680	200	40
Philippines	-1,939	-2,667	-2,805 ^b
South Korea	-3,160	-2,950	-780
Venezuela	9,070	8,770	2,920 ^b
Yugoslavia ^c	-5,660	-5,280	-3,780

^a Trade balances were derived using seasonally adjusted customs-basis exports and imports. Exports and imports are valued f.o.b. For some countries, trade balances computed on a customs basis do not agree with those computed on a balance-of-payments basis.

^b Estimated.

^c Trade balances are based on hard currency exports and imports.

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Secret

27 May 1983

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imports also fell in 1982, but larger declines in exports led to a worsening in their trade accounts. Venezuela's trade surplus narrowed last year largely because of a sharp fall in oil export revenues. The trade balances of a number of key debtor countries should improve further this year. Countries under IMF programs will be cutting back imports in an effort to meet their foreign exchange targets—Mexican imports in the first quarter were down more than two-thirds from their 1982 first quarter level. Sizable currency devaluations since midyear 1982 in countries such as Argentina, Brazil, Chile, and Mexico may also contribute to an improvement in trade balances. []

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*West German
Opposition to
Trade Restrictions*

West German Government and industry officials are increasing their criticism of revisions to the Export Control Act that are currently under consideration by the US Congress. Economics Minister Lambsdorff, in an interview in a West German financial periodical, said West Germany considers the Act unacceptable. Bonn particularly opposes the extraterritorial provisions, which would penalize US companies' European subsidiaries that do not comply with US controls on East-West trade. Lambsdorff said his country wants to avoid a repetition of the dispute last year over pipeline sanctions and will make its position clear to US officials at all levels, including those at the Williamsburg summit. []

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Bonn is under pressure from West German industry, especially the machine tool sector, to resist US provisions that would restrict its trade with the East. The Eastern market accounts for up to 50 percent of sales for some firms, and industry officials are especially concerned about provisions that would require—on a case-by-case basis—proof that the exports do not improve Soviet military or strategic capabilities. They would prefer that the burden of proof rest with those seeking to restrict technology transfer. West Germany's concern about the Act is shared by other European countries and could seriously hamper efforts to reach an accommodation on East-West trade issues in OECD, COCOM, and NATO studies now under way. []

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*Polish Debt
Rescheduling*

The Paris Club—the group of major Western governments responsible for rescheduling Poland's officially backed debt—has agreed to delay a decision on new negotiations until Warsaw provides previously requested information on its adherence to the rescheduling agreement of 1981 and explains its unequal treatment of creditors. The governments have asked Warsaw to respond by the end of next month. The Paris Club is to meet in late July to decide whether to proceed with a rescheduling of obligations for 1982 and 1983. Many governments believe that the stalemate on renewing negotiations benefits only Warsaw and Western banks because Poland has made no payments on officially backed debts since December 1981. It has paid \$2.2 billion to commercial banks under their rescheduling agreements. []

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The creditors probably will become disunited if the Paris Club does not resume negotiations with Poland after the meeting in July. The handling of the Pope's visit to Poland will be a critical factor in the Western governments' decision in July. Neutral governments—particularly Sweden and Switzerland—are anxious to reschedule, and a move by these countries would increase pressures within some allied governments to break ranks as well. The governments have not yet discussed rescheduling terms among themselves, and any proposal that does not include new loans probably will be rejected by Warsaw. Even if agreement is reached on terms, Poland does not have enough liquid funds to meet its obligations under the Paris Club agreement of 1981 and still make payments due under the commercial bank reschedulings of 1981 and 1982.

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Possible Soviet-Mexican Technical Cooperation

The US Embassy in Mexico City reports that earlier this month a Soviet delegation led by a deputy minister of petroleum toured the facilities of the Mexican state oil company, Pemex, and signed a memorandum calling for technical cooperation. The memorandum proposes scientific and technical exchanges in oil-related areas such as drilling, production, and transportation. Details of future cooperative projects reportedly are to be worked out by specialists. One Mexican official played down the memorandum by telling a US diplomat that it is only an offshoot of the Soviet-Mexican scientific and technical cooperation agreement of 1975.

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The USSR may hope to use any new cooperative arrangements to acquire advanced US oil-related technology from Mexico, which is not a member of COCOM and which imports substantial oil equipment and technology from the United States. Mexico's efforts to avoid violating US export controls, however, could limit Soviet opportunities to obtain such technology. Moscow may also hope to make additional sales of oil-related equipment to Pemex, which has purchased some Soviet-manufactured drilling equipment in the past.

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Portugal Secures \$300 Million Eurodollar Loan

The completion of a \$300 million Eurodollar credit for Portugal late last week will do little to improve Lisbon's image in international financial markets or to ease its acute shortage of foreign exchange.

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The initial disbursement of the loan will amount to only \$50 million, the equivalent of two days of imports, and the next installment of \$25 million is not due until December. Hard currency reserves amount to only slightly more than two weeks of imports, despite a \$400 million gold swap with the Bank for International Settlements last month. Since Portuguese officials are not likely to be able to arrange additional financing until IMF assistance is lined up, they may be obliged to carry out further gold swaps or, as a last resort, to sell part of Portugal's nearly \$9 billion in gold reserves during the interim.

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27 May 1983

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*Canada Averts Trade
Dispute With China*

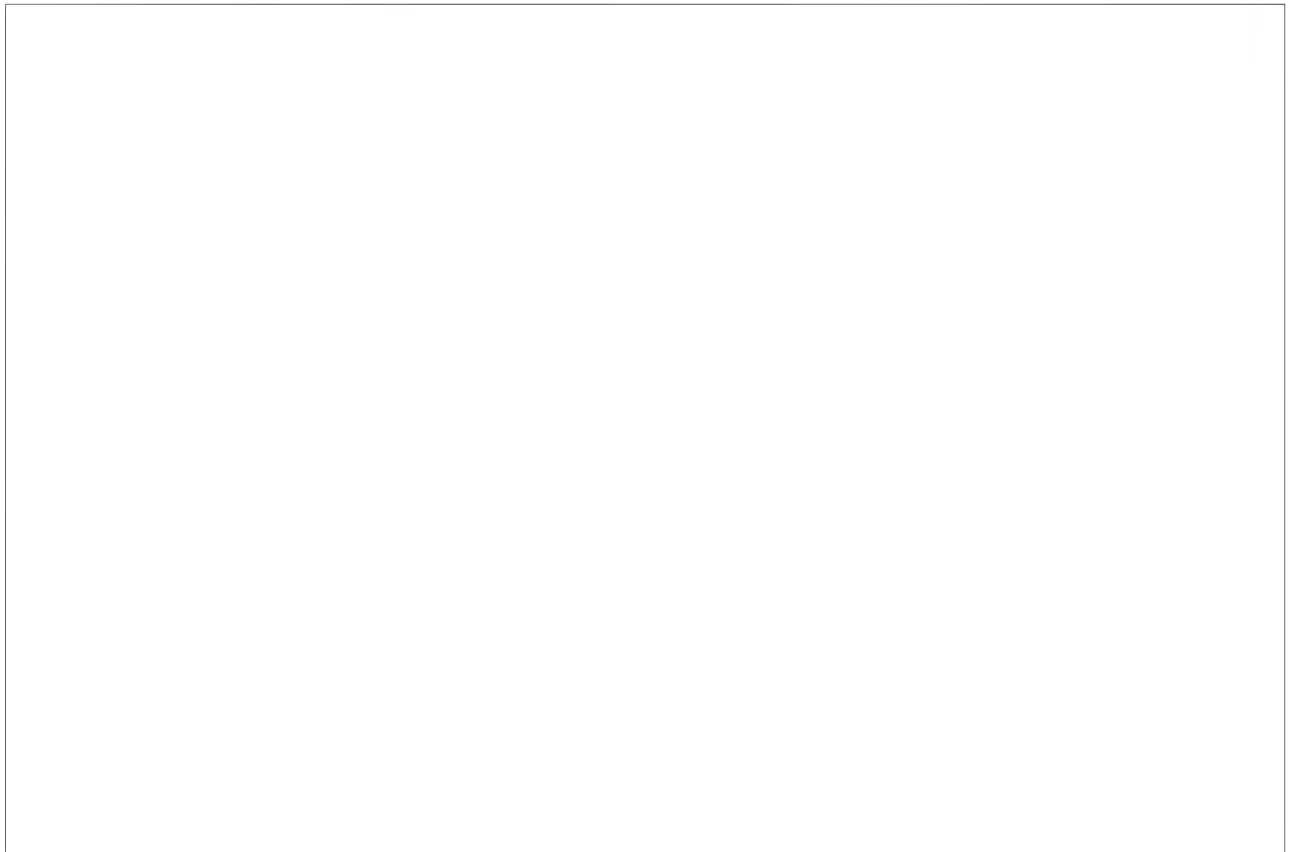
Canada has dropped plans to trim imports of Chinese textile products after Beijing threatened to stop buying Canadian grain and forest products. The Canadians proposed the reduction in February in order to protect domestic textile and apparel producers from low-priced Chinese goods. Ottawa apparently is convinced that the threat is sincere, based on China's withdrawal from US grain markets since the impasse on textile talks. Although we believe China is avoiding US markets primarily because of high prices, Canada does not wish to chance losing an important customer—which purchased about \$700 million in grain, wood, and paper products last year—over a few million dollars worth of textiles and apparel.

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National Developments

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Developed Countries



*EC Farm Price
Increases*

EC agricultural ministers last week agreed to raise farm prices for the 1983/84 marketing year by the smallest amount in 10 years—4.2 percent in terms of European Currency Units (ECUs). Last year's increases averaged 10.4 percent in ECUs—12.2 percent in national currencies. Negotiations over

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agricultural prices became deadlocked over two months ago because Italy demanded \$230 million in interest rate subsidies for its farmers to offset the relatively low price increases. Moreover, EC farmers and the European Parliament had demanded a 7-percent price hike. EC members kept increases low because EC finances will be severely strained next year; Italy was given a grant of \$55 million and limited special measures were approved for other member countries.

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European Community: Farm Price Increases, *Percent*
Marketing Year 1983/84

	European Currency Units	National Currencies
EC-10	4.2	6.9
Belgium	4.4	7.7
Denmark	4.0	4.7
France	4.0	9.4
Greece	5.6	25.8
Ireland	4.2	9.0
Italy	4.5	8.8
Luxembourg	3.9	7.2
The Netherlands	4.0	2.6
United Kingdom	4.1	4.1
West Germany	4.1	2.0

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Price increases in national currencies for individual EC countries will vary widely because the ministers also agreed to adjust the EC's green currency system—the fixed exchange rates used to convert farm prices in ECUs to national currency units. For example, farm prices for West German farmers will rise only 2 percent in marks while those for Greek farmers will go up 26 percent in Drachmas. Commission officials almost certainly will point to this year's small increases as proof of the EC's determination to cut agricultural spending at the 3 June session of the ongoing US-EC talks on agricultural trade problems.

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**Australian Interim
Budget**

The Hawke government's interim budget reflects the Prime Minister's concern over the projected \$7.5 billion budget deficit for 1983/84. The costs of a \$500 million jobs program will be more than offset by nearly \$900 million in tax hikes and spending cuts in other programs. Because of the budget's overall deflationary effect, the country's record 10.3-percent unemployment rate

Secret
 27 May 1983

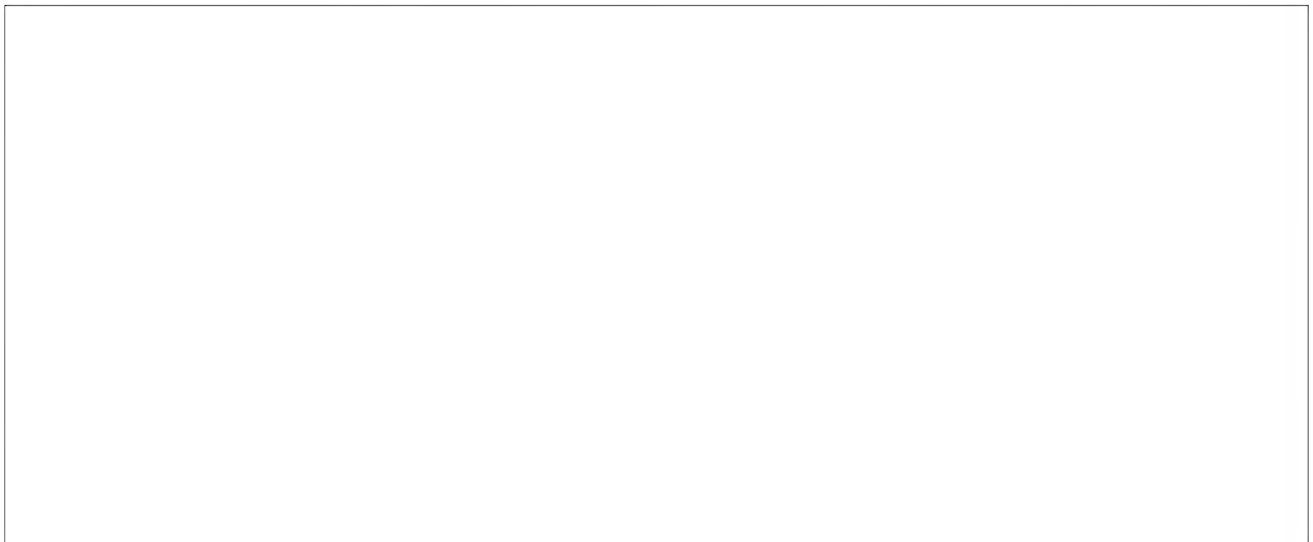
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probably will continue to increase. The jobs program is also an attempt by the government to undercut growing union criticism of the wage freeze, which Hawke wants to extend beyond the 30 June expiration date. In any case, the interim budget foreshadows major changes in the full 1983/84 budget, which will be presented in August and is likely to include further spending cuts and tax increases. []

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Less Developed Countries



Venezuela's Exchange System Causing Problems

Industrialists are now publicly calling on Caracas to modify the multiple exchange system, introduced in March, to prevent spreading economic disruptions. Through 28 April the government authorized dollar transactions at the preferential rates totaling only \$180 million—mostly for food imports. The US Embassy estimates that Venezuela's essential imports—including capital equipment and raw materials—are valued at \$800 million per month. []

[] the private sector has been unable to obtain dollars at the preferential exchange rate, thereby causing difficulty in importing goods and servicing debt since the end of February []

Despite business complaints, Caracas has been deliberately slow to clarify the new foreign exchange regulations in an effort to stem the loss of liquid foreign reserves, which now stand at about \$3.5 billion. Thus far, the tactic has enabled the Central Bank to build up reserves by some \$400 million during March and April. At the same time, however, the current exchange system is laying the foundation for more serious economic problems:

- The US Embassy reports some spot shortages of consumer items, and industrial inputs have caused factory shutdowns and new layoffs.
- Businessmen face a severe profit squeeze because they are unable to offset increased foreign exchange costs in the face of the government's extension of controls on prices.

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[redacted]

We expect Caracas will try to increase the availability of dollars to prevent shortages of basic goods and production slowdowns. [redacted]

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*Brazil Grain
Production Plan*

[redacted] Brazil is drawing up a plan to increase grain and oilseed production by at least 10 million tons within the next two years. To meet this goal, Brasilia plans to increase acreage in the new farmlands of central Brazil. Brazil decided to raise grain and oilseed production because of the need to increase export revenues and to fill a perceived opening in the international grain market as a result of acreage reduction programs in the United States. Given the proper external financial support, a doubling of Brazil's grain and oilseed exports by 1985 is possible. Combined with significant Brazilian exports of corn for the first time since the mid-1970s, increased exports will aggravate the mounting glut in the world grain market.

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*Tanzania Backtracks
on Economic Initiatives*

Dar es Salaam's recent efforts to stem Tanzania's economic decline have already begun to dissipate. Although the atmosphere of meetings held in April between Tanzanian officials and IMF representatives reportedly was better than in late 1982, the two sides remain far apart on key issues—including devaluation and controls on consumer prices. President Nyerere has whittled away most private incentives initially included in Tanzania's much vaunted new agricultural policy. The government's zealous anticorruption campaign has backfired because many shopkeepers have closed their doors rather than risk prosecution for what until recently were normal business practices.

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[redacted] the crackdown is adding to disgruntlement within the military by punishing soldiers who had been profiting from unlicensed businesses and the resale of subsidized government food supplies.

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Threatened with a cutback in foreign aid, Nyerere has begun to take unpopular stopgap measures to keep the country solvent. Unable to find cash to meet expenses, he has ordered businessmen to sell essential commodities to the government on credit, which rarely is repaid promptly, if at all. [redacted]

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27 May 1983

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*Jamaican Economic
Troubles Grow*

The IMF and Jamaica have reached a preliminary agreement on financial aid for a third year, but the terms of the program will severely limit the country's economy in the short term. A \$150 million loan promised by Kuwaiti lenders is an important part of the aid package. Jamaica has reluctantly agreed that, if the loan falls through, it will automatically implement difficult austerity 25X1 measures. The agreed actions would include shifting an additional \$150 million in imports from the subsidized official rate to a more costly commercial level. The agreement also requires Jamaica to make major reductions in government spending, in the money supply, and in the growth of credit.

The US Embassies in Jamaica and Kuwait are skeptical that the Kuwaiti loan will materialize and believe that the contingency provisions are likely to come into effect soon after final IMF approval, perhaps late next month. Jamaica probably will be unable to avoid a contraction of its economy this year or to keep unemployment from rising above the current level of 28 percent. Increased foreign purchases in the costlier commercial foreign exchange market will help to push inflation above the 15-percent rate that is already anticipated. The failure of the economy to improve next year would damage Prime Minister Seaga's chances in the next election, which has to be held by October 1985.

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*Communist**China Expanding
Communist Trade Ties*

China plans to increase trade substantially with Eastern Europe as well as the USSR this year. Since signing the March protocol to increase trade with Moscow to \$800 million this year—the highest level since the early 1960s—Beijing has also concluded trade agreements with a number of East European countries specifying significant jumps over last year's levels: Hungary increases 80 percent; Czechoslovakia, 50 percent; Poland, 48 percent; East Germany, 25 percent; and Bulgaria, 15 to 20 percent. China even signed a \$100 million trade agreement with Albania when trade representatives visited Tirana in March—the first such meeting since 1978.

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In addition, Beijing signed agreements that will boost trade with Romania 25 percent to \$1.1 billion and with Yugoslavia to \$180-200 million—triple the value reached last year. Recognizing the difficulty these trade partners have in filling their energy needs, China agreed to increase exports to Romania on a barter basis and arranged a three-way swap to supply Yugoslavia with Nigerian oil.

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With these increases, the USSR and Eastern Europe may account for about 8 percent of China's trade in 1983. Beijing's decision last year to save foreign exchange by renovating existing Soviet-built plants instead of importing new high-technology plants from the West has made trade with Eastern Europe more attractive. Some Chinese leaders apparently also see Eastern Europe as a market for goods China cannot sell to the United States. Moreover, China may see trade as a means of rebuilding political ties with some Warsaw Pact states at Moscow's ultimate expense. Beijing's recent diplomatic and economic initiatives are clearly intended to help Romania and Yugoslavia maintain their independence from Moscow.

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27 May 1983

Secret

Lebanon: Economic Consequences of a Negotiated Settlement

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The vitality of Lebanon's predominately trade- and service-based economy depends heavily upon Beirut's relations with its Arab neighbors. A large portion of Lebanon's exports go to Arab states that are also the source of substantial flows of remittances and other services earnings. Arab reaction to the Lebanese-Israeli accord on foreign troop withdrawals could have a significant impact on these vital links.

A Syrian-led embargo without the compliance of moderate Arab states, which so far have supported Beirut's signing of the agreement, could easily be circumvented. If the agreement evolves into full normalization of relations with Israel, however, it will most likely provoke a much broader Arab backlash. Even this could be weathered if Israel and Western countries opened their borders to Lebanese goods, and Arab sanctions—as in the case of Egypt—do not apply to transfers of worker remittances and other private funds.

Lebanon's Economic Relations With Its Arab Neighbors

The advantages of Lebanese-Arab economic ties flow in both directions, but the bulk of the financial benefits has historically accrued to Beirut. In the early 1970s, trade and services provided as much as 55 percent of the country's GNP and employed nearly 50 percent of the labor force.¹ Growth in this sector was the major impetus behind Lebanon's respectable 7.5-percent average annual real GNP growth performance in the 1970-74 period. Moreover, roughly 50 percent of Lebanon's foreign exchange receipts originate in the Arab world.

¹ Statistics used in this paper are derived from random and ad hoc sources because Lebanon has not published a consistent data series since 1975.

Trade

Neighboring Arab states became a lucrative export market for Lebanese agricultural and light industrial goods following the 1973-74 oil boom. Low transportation charges heightened the attractiveness to Arab importers. Overall exports increased sevenfold to \$1.5 billion from 1970 to 1974, with a similar increase recorded in exports to Arab states; in particular, exports to Saudi Arabia increased nearly 13 times in that period. By 1981, about 60 percent of Lebanon's exports and over 95 percent of its industrial exports were being marketed in just six Arab states—Saudi Arabia, Iraq, Syria, Kuwait, Jordan, and Egypt.

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Lebanon's imports from its Arab neighbors totaled only \$560 million in 1981, about 14 percent of the total. Of this, oil—mainly from Iraq in 1982—accounts for over 90 percent. The Trans-Arabian pipeline (Tapline) from Saudi Arabia and the Iraqi-Syria-Lebanon pipeline were meant to feed refineries at Sidon and Tripoli, respectively. Fighting in Lebanon and political disputes between one or the other of the countries involved have interrupted pipeline deliveries. Currently, oil is being brought in by tanker because of war damage to Tapline and Syria's decision to cut off Iraq's major export route as a show of support for Iran.

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Remittances and Aid

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Remittances from Lebanese workers in the Gulf have increased significantly since the oil boom. Gross remittances of \$230 million offset 55 percent of Lebanon's trade deficit in 1970. In 1982, remittances reached \$3 billion; open sources reported that about 250,000 Lebanese working in the Gulf

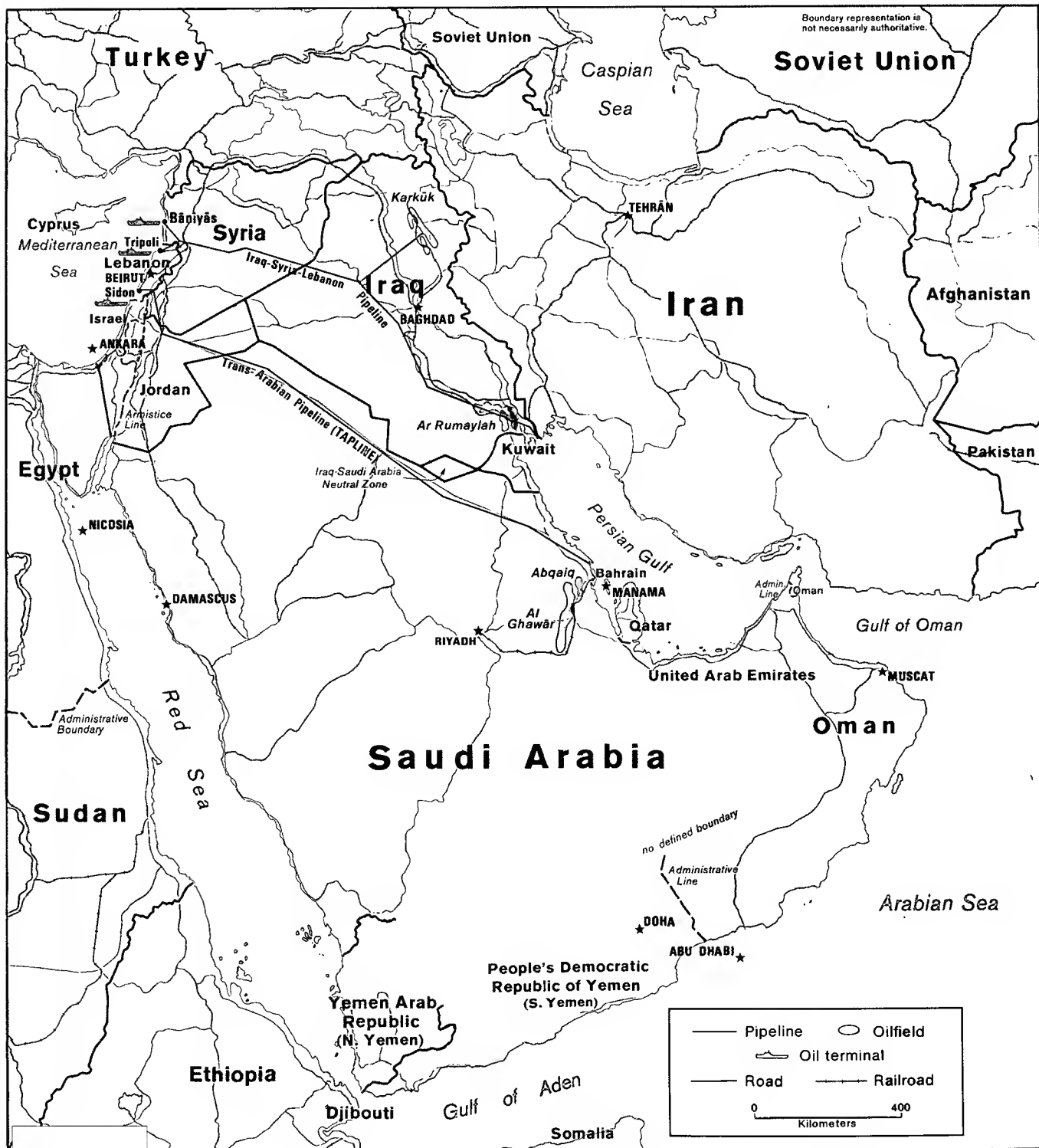
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27 May 1983

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27 May 1983

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Lebanon: Foreign Trade ^a

Million US \$

	1970	1974	1980	1981	1982 ^b
Exports	192.1	1,463.0	1,200.0	1,252.0	850.0
Saudi Arabia	28.7	396.1	340.5	344.9	
Iraq	11.3	41.9	113.0	164.0	
Syria	13.3	87.5	80.6	83.8	
Kuwait	22.8	50.8	68.9	68.9	
Jordan	11.3	23.4	44.4	50.4	
Egypt	3.8	73.8	23.3	36.6	
Other, mainly OECD	100.9	789.5	529.3	503.4	
Imports	604.8	2,455.0	4,162.6	3,945.6	2,700.0
Saudi Arabia	6.6	55.6	392.0	450.0	
Iraq	27.7	52.3	137.7	55.1	
Egypt	3.3	13.8	19.8	25.0	
Syria	23.0	57.8	13.9	25.0	
Jordan	5.6	13.7	7.7	7.7	
Other, mainly OECD	538.6	2,261.8	3,591.4	3,382.8	

^a Lebanese post-1975 trade data are derived from the Direction of Trade Statistics and from spot reports from the US Embassy in Beirut.

^b Estimated from third-quarter trade returns.

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states alone sent home about \$1.5 billion, over 80 percent of the estimated trade deficit. (These funds included remittances of Palestinians in the Gulf, who were sending funds to families in refugee camps in Lebanon.) The availability of jobs outside the country has also provided an important source of employment for workers displaced by strife-induced disruptions to the Lebanese economy. []

to financial difficulties in the donor countries—Algeria and Iraq are cases in point—but most of the shortfalls have stemmed from donor country reaction to security and political developments in Lebanon. []

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Benefits to the Arab States

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Arab aid, which has never met commitments nor expectations, has had a much smaller impact on the Lebanese economy. At the 1979 Arab summit in Tunis, seven of the richer Arab states—Saudi Arabia, Kuwait, Libya, Iraq, the UAE, Algeria, and Qatar—pledged \$2 billion over a five-year period for reconstruction and development projects in Lebanon. As of March 1983, according to the US Embassy, Beirut had received only a little over \$400 million, about one-third the amount due since the summit. Some of the backsliding has been laid

Lebanon's role as a regional trade and financial center has diminished sharply since the mid-1970s. Beirut, once a leading financial center for the Arab world, has seen its role eclipsed by the development of banking facilities in Bahrain and other Gulf Arab states. Moreover, many Arab governments now prefer to make their own transactions directly through New York or Western Europe. Beirut's role in facilitating regional trade has also fallen off, in large part because of continuing domestic strife.

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A good portion of Arab trade traditionally passed through Lebanon, and although the country continues to expedite some trade to Arab States via road and rail links from Syria and Jordan, the volume has declined since the Lebanese civil war in 1975. In 1980, Beirut reported reexports of \$320 million, 95 percent of which went to Arab states, according to the Beirut Chamber of Commerce. Today, Lebanon's major economic role in the region probably lies in the expertise and skill of its expatriate workers in neighboring Arab states. []

Prospects for Sanctions

Now that Lebanon and Israel have come to an agreement on security arrangements, negotiations will turn to the issue of "normalization" of relations, including Lebanese repudiation of the Arab boycott. The Israeli view, according to press reports, is that "there is no security without peace, no peace without normalization, and no normalization without at least a limited amount of trade." Radical Arab governments, led by Syria, are likely to call for punitive measures if the Gemayel government makes this kind of peace with Israel. Even moderate Arab states like Saudi Arabia, Kuwait, and Jordan, concerned with the status of Jerusalem and the West Bank, would oppose formal Lebanese ties with Israel and would probably join with the radicals to impose at least a token boycott against Lebanon. []

The effects of these measures would, of course, depend on the kind of boycott undertaken and the extent to which it was adhered to by area Arab countries. A selective boycott against Lebanese firms that do business with Israel would probably have a very limited impact; few Lebanese companies would be likely to risk their valuable Arab trade ties to do business with Israel. A similar move against Egypt after Camp David had little effect on Cairo's day-to-day economic activities. A trade and transport embargo implemented only by Syria and other radicals—South Yemen and Libya—would also do minimal damage. Syria took only about 7 percent of Lebanese exports in 1980 and 1981.

Moreover, goods that normally transit Syria could be shifted to other routes, even though transport costs would rise somewhat. []

More comprehensive measures, however, could present Beirut with some serious problems. A boycott, joined by moderate Arab states would affect 60 percent of export earnings and over \$300 million in transit trade. Because of its close aid ties with Saudi Arabia and the other Gulf oil producers, even Jordan might be persuaded to join an embargo. []

Saudi and Jordanian disquiet over the flow of Israeli products into Lebanon since the invasion has already led to a limited boycott against Lebanese goods. From mid-March to mid-April Riyadh banned some foodstuffs, clothing, textiles, and electrical equipment, whether made in Lebanon or imported. The US Embassy in Riyadh believes, and we concur, that a more extensive Saudi ban could be imposed if an agreement with the Israelis leads to open borders and a free flow of goods. Additionally, Amman announced in early March that import licenses would not be granted to non-Lebanese goods coming from Lebanon without proper documentation. []

A full or partial trade embargo would be the most visible way for the Arabs to demonstrate their displeasure, and the least disruptive to their economies:

- Imports that normally transit Lebanon could be easily shifted to other transit points such as Jordan, Turkey, or other points in Western Europe.
- Lebanese agricultural exports could be replaced by purchases from southern Europe.
- A show of solidarity with other Arab states would not impose an inordinate burden on Baghdad—which has taken about 30 percent of Lebanon's industrial exports since 1979—because this trade

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27 May 1983

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has already fallen off with the Syrian-Iraqi border closure and Iraq's growing financial problems. []

Prospective future aid to rebuild Lebanon would almost certainly fall victim to an Arab boycott. Lebanon's potential benefactors maintain that the security situation has hampered aid donations, implying that more may be forthcoming once the situation improves. An agreement, however, that ignores Arab opposition to normalization of relations with Israel before a comprehensive peace settlement will virtually assure continued tightfistedness on the part of Saudi Arabia and other Gulf states. []

Most of Lebanon's other ties to its neighbors are not as vulnerable as trade. The Gulf states are unlikely to expel their Lebanese workers, reasoning that the quarrel is with the government in Beirut and that workers should not be penalized. In addition, many are in skilled positions that could not be easily filled by locals. Moreover, existing direct business arrangements are not likely to be disrupted, since most benefit members of the ruling families in the parent countries. []

Longer Term Options

The Lebanese would have few options in the event of an Arab boycott. Development of alternative markets for its agricultural and light industrial exports would be especially hard. Lebanon's other natural export markets are Israel, Egypt, and Southern and Western Europe. In the case of Israel, despite the Begin government's encouragement of a limited level of exports to Lebanon since the invasion, trade has only been permitted to flow one way. Much of Lebanon's agricultural produce directly competes with Israeli goods. Tel Aviv, however, might be persuaded to lower barriers to Lebanon's exports in exchange for normalization. In the absence of trade barriers, Lebanese industrial products could probably compete on the Israeli market. []

Egyptian officials would probably want to be as helpful as possible in the event of an embargo against Lebanon. The Egyptians realistically believe that Beirut will have to take some steps to normalize relations with Israel to achieve a troop withdrawal. Economically, Egypt could probably absorb more of Lebanon's exports and would be a possible source of oil if Iraq decided to turn off the spigot. High West European trade barriers against agricultural products and semifinished textiles would preclude large-scale imports of Lebanese goods without special provisions. [] 25X1

As far as aid is concerned, the active involvement of the United States in the negotiations will no doubt make Washington, at least in President Gemayel's estimation, the potential donor of first resort should the political and security conditions in Lebanon stabilize to the point where reconstruction can begin. The dynamic Lebanese private sector, however, could garner most of the funds necessary to rebuild the country on their own, either domestically or through international financial institutions. While Arab funds and backing would certainly make the task much easier, lack of it will by no means preclude a substantial reconstruction effort. [] 25X1

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Jordan: Coping With Slower Economic Growth ¹ []

The rapid growth in Jordan's key sources of foreign exchange is grinding to a virtual halt, reinforcing King Hussein's reluctance to take foreign policy measures—such as negotiating with Israel—not supported by Saudi Arabia and his other Arab financial backers. Amman's most immediate financial concern is rapidly rising military debt payments. As of 14 May Amman was \$204 million in arrears on payments to the United States, and total payments due this year are reported to total \$1.3 billion. []

Worsening Balance of Payments

The key external forces that have pulled Jordan's economy rapidly ahead over the past decade slowed dramatically in 1982:

- The decline in oil prices and concomitant economic slowdown in the Gulf virtually halted growth in worker remittances.
- Iraq's financial problems severely cut into its demand for Jordanian exports.
- Arab donors slowed their aid payments.
- Prices for phosphate—a major export—remained soft.

These trends combined to produce an estimated record \$1.5 billion civilian current account deficit; military imports were an additional several hundred million dollars. Meanwhile, real GNP growth dropped to less than one-half the 16 percent achieved in 1980. []

Although Jordan's foreign exchange position improved somewhat in the early months of 1983—the

¹ Statistics used in this paper are derived from random and ad hoc sources because Lebanon has not published a consistent data series since 1975. []

Jordan: Expenditure on GNP, 1981 *Million US \$*

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Consumption	4,245
Private	3,366
Government	879
Gross fixed capital formation	1,736
Change in stocks	71
Exports	1,935
Imports	4,279
Gross domestic product	3,708
Net factor income from abroad	979
Gross national product	4,687

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receipt of a \$225 million Euroloan negotiated in late 1982 raised reserves to \$940 million or three months of civilian merchandise imports at the end of March—we expect the balance of payments to deteriorate during the rest of 1983. Foreign exchange receipts are likely to drop, and payments for past purchases of weapons will rise substantially. []

Of the \$1.25 billion in Arab aid due Jordan under the 1978 Baghdad agreement, we expect that Jordan will receive just \$780 million this year. Libya and Algeria have usually reneged on their commitments. []

The Saudis and the smaller Gulf states will probably continue to fulfill their Baghdad commitments; they view the Baghdad subsidies as one of the few remaining expressions of Arab solidarity against Israel. The United Arab Emirates and Qatar, however, probably will delay writing their checks as long as possible, as they did in 1982, leaving only Saudi Arabia and Kuwait likely to pay on a timely basis. []

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Secret**Jordan: Prospects for
Baghdad Aid, 1983***Million US \$*

Donor	Annual Commitment	Status
Saudi Arabia	357.1	Likely to pay
Kuwait	196.4	Likely to pay
Libya	196.4	Defaulted
Iraq	185.7	Defaulted
United Arab Emirates	142.9	Slow payer
Algeria	89.3	Defaulted
Qatar	82.1	Slow payer

Total commitments: 1,250
Maximum 1983 receipts: 780

Although Jordan's five-year development plan is counting on net worker remittances to grow 10 percent annually, we expect that they will grow much more slowly, if at all, over the next three years. The soft oil market and the resulting financial pinch throughout the oil-rich Arab states have prompted postponements of new projects and efforts to cut back foreign work forces. In a recent conversation with a US Government official, Jordan's Under Secretary of Labor projected that the number of new workers going to the Gulf this year will total just 4,000 compared with 12,000 in 1979. One senior official in Amman has told the US Embassy that remittances actually declined in the early months of 1983. Kuwait has already frozen the number of non-Kuwaitis on the public payroll and is attempting to cut the government's foreign labor force by 10 percent. [redacted]

Phosphate exports account for one-third of Jordanian merchandise exports, and we expect phosphate prices, which declined about 8 percent in 1982, to fall again this year. The US Embassy reports that Jordan is already selling its phosphate at less than the cost of production. Even if world demand picks up, the market is likely to remain soft as Morocco, the world's major exporter of phosphates, will probably boost production to ease its own

balance-of-payments problems. The outlook for fertilizer—another key Jordanian export—is also dim.

Rising Military Debt

[redacted]
foreign debt payments for purchases of military equipment will rise dramatically this year to [redacted] well above expected Baghdad receipts. If Jordan makes these payments on time, we estimate that total military expenditures will absorb just over one-fourth of GNP in 1983, up from roughly 12 percent in 1982. By comparison, we believe that, in years past, the military had been able to live within its usual allocation of about 40 percent—\$250-450 million—of Baghdad aid receipts. [redacted]

Although a detailed breakdown is difficult as Amman publishes no information on its military debt or military imports, we believe that the bulk of the debt is due to France, the United Kingdom, and the United States. [redacted]

The Jordan Armed Forces (JAF) is traditionally responsible for meeting payments on military debt

[redacted] As of 14 May, the JAF had already fallen \$204 million into arrears on its payments to the United States for cash purchases and past loans under the Foreign Military Sales (FMS) program. [redacted]

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Jordan: Balance of Payments

Million US \$

	1967	1973	1976	1981	1982 ^a	1983 ^b	1985 ^c
Trade balance	-120	-271	-813	-2,464	-2,556	-2,640	-2,723
Exports	32	58	207	744	824	860	1,828
Imports	152	329	1,020	3,208	3,380	3,500	4,551
Services balance	42	70	508	1,103	1,047	1,100	1,480
Net worker remittances	18	45	390	888	920	920	1,057
Tourism	4	2	111	182	97	150	^d
Other	20	23	7	33	30	30	423
Private transfers	7	11	11	47	30	50	^d
Current account balance	-71	-190	-294	-1,314	-1,479	-1,490	-1,243
Capital account balance	134	196	271	1,431	1,389	1,270	1,243
Official transfers	144	187	370	1,273	994	950	838
Other	-10	9	-99	58	395	320	405
Errors and omissions	14	7	5	-175	-111	140	0
Changes in reserves	77	13	-18	-58	-201	-80	0

^a Estimated.^b Projected.^c Projection based on the 1981-85 development plan.^d Not specified.

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Finding the Money

Drawing on reserves, however, to meet a substantial share of the JAF's debt payments would leave the government only a thin cushion to cope with any other sudden foreign exchange shocks such as the default of another major donor or a steep decline in phosphate prices.

Little official consideration has apparently been given to drastically cutting back the budgets of other government departments to accommodate the military's needs. Moreover, we believe Amman will be reluctant to resort to import restrictions, devaluation, or sharply higher customs duties to conserve

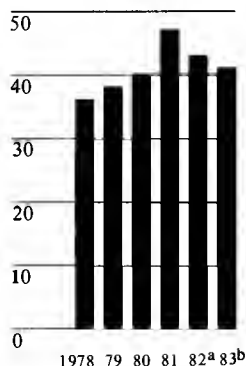
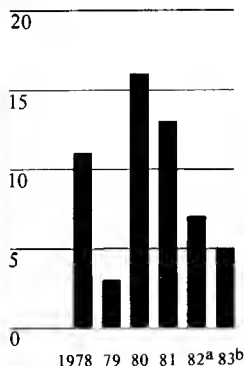
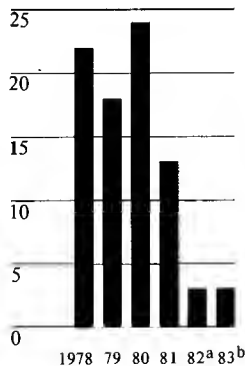
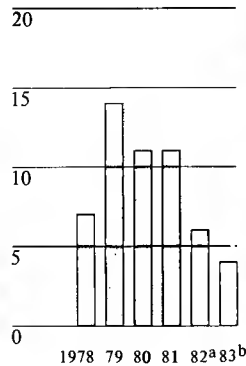
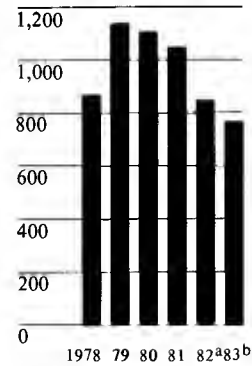
foreign exchange. Such steps would cut heavily into customs revenues, the government's main source of domestic income. In addition, the Central Bank 25X1 believes that the debt problem is temporary; Central Bank Governor Nabulsi has stated that the current high level of military payments is a temporary bulge and that by mid-1984 payments will drop substantially. Jordan is not known to be in 25X1 arrears on any of its nonmilitary external public debt of roughly \$1.7 billion. 25X1

Financing the debt service through a second Euro-market loan is a more likely possibility. In late 1982 Jordan was able to borrow \$225 million on the Euromarket at surprisingly favorable terms—just one-half percentage point above LIBOR. Similar terms, however, would not be available for a second loan. In early April 1982, while the Euro-

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Secret**Jordan: Key Economic Indicators**

Note change in scales

**Investment As A Share
of GDP**
Percent**Real GNP Growth**
Percent**Growth of Industrial
Production**
Percent**Inflation**
Percent**Foreign Exchange
Reserves**
Million US \$^a Estimated.^b Projected.

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market would have few qualms about lending Jordan another \$300-400 million, the spread would have to be at least 0.875 percent, one point above LIBOR. Since then, the spread has probably risen even higher, due to the growing political and military tension in the area.

The remaining option for the government is to obtain more foreign aid. Although Amman has tried hard to persuade the Saudis to foot the bill, so far the King has only been able to get \$50 million over and above the Saudis' Baghdad payments, with the promise of about another \$200 million to come. While Riyadh has made a \$119 million installment on its 1983 Baghdad commitment, the other three Arab states still honoring their Baghdad obligations have not yet done so. (The Kuwaitis traditionally make their first payment in June.) Until they do, additional Saudi aid is not likely to significantly ease the government's financial situation.

Domestic Consequences

Amman's inability to sustain past economic growth levels has prompted increased criticism of the King and demands for more popular participation in government decisions. The US Embassy reports that Jordan's business community, which views Prime Minister Badran and his Cabinet as strongly antibusiness, is increasingly critical of the government's price controls and other economic policies. Some businessmen are also beginning to question the wisdom of the King's continued close alliance with Iraq, according to the US Embassy. Hussein has actively encouraged Jordanian companies to do business with Iraq, and, as Iraq's foreign exchange crisis has intensified, Baghdad has stopped payment on a number of contracts with Jordanian merchants. The situation has become so worrisome that the Central Bank has recently announced the formation of a credit facility to bail out overextended Jordanian firms.

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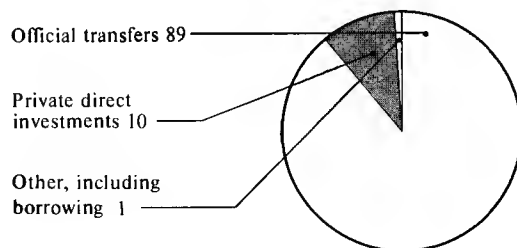
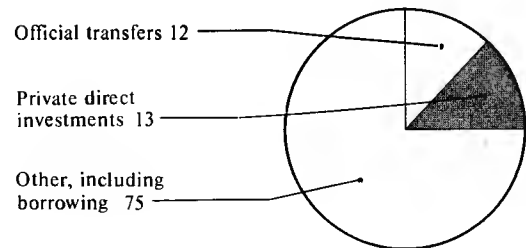
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Jordan: Comparison of Capital Accounts, 1981

Percent

Jordan**Average Non-Oil LDC**

^a It should be noted that neither of these charts take account of military indebtedness.

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We believe that shrinking job opportunities in the Gulf, continued rapid population growth, and the domestic slowdown presage the return of domestic unemployment, which virtually disappeared between 1975 and 1981. Large numbers of highly skilled, well-educated young Jordanians who anticipated lucrative jobs in the Gulf states or in Amman could be in for a rude awakening. The government is attempting to remedy the structural mismatch between the types of jobs available domestically and the high skills of Jordanian workers by opening vocational training centers. Many young people, however, whose professional expectations are much higher, are reluctant to enroll.

Jordanians risk the political stability they have enjoyed since the civil war of 1970-71. Although fundamentalist sentiment is increasing in the universities—most visibly in the number of veiled women—we do not believe that violent, fundamentalist reaction to current problems is likely.

Hussein is, however, a cautious politician who would prefer to avoid domestic grumbling. In an attempt to stave off criticism, Hussein would probably allow an increase in the scope of public debate over economic policy alternatives so long as his monopoly on power is not questioned.

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We do not believe that businessmen or other groups hurt by the economic slowdown are currently ready to assume the considerable risks of mounting a determined challenge to the King. Although the economic outlook for the next several years is worsening, we agree with the US Embassy's assessment that only if avenues to a better life are firmly closed will socially and economically deprived

Implications for the United States

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Although Jordan has occasionally fallen into arrears on its US debt before, Amman is proud of its reputation as a fiscally prudent state and is extremely sensitive to what it perceives as undue outside concern. US military officials in Amman

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have reported that some working-level JAF officers are suspicious that the recent rounds of discussions with the United States over Jordan's arrearages represent an attempt by Washington to pressure Jordan on political issues, particularly on the Reagan peace initiative.

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Jordan's dimming economic prospects and current foreign exchange worries mean that Hussein cannot afford to antagonize his major financial backers and will not make political moves that run a strong risk of entailing a further decline in their financial aid and political support to this regime. He will want firm Gulf-Arab backing before joining any peace negotiations with Israel. Hussein has always regarded financial assistance as a sign of political support, and, in the event that he may yet agree to join the US peace initiative, he will expect a major increase in US and other Western economic assistance, possibly including a relaxation of requirements for military debt service.

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27 May 1983

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Public Services in Cairo: Potential for Unrest

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Decades of rapid population growth, inadequate maintenance, and insufficient investment have produced a public services crisis of major proportions in Cairo. The problems caused by unreliable or inadequate water, electrical, waste disposal, and transportation systems are constant sources of frustration to Cairenes, impede commerce and investment, and could ultimately spark serious outbreaks of domestic unrest. The remarkable forbearance displayed by the public may not last. A groundswell of public anger following a major sewer break in an older section of Cairo in July 1982 led to the deployment of security forces in the area and demonstrated the serious potential for urban violence.

Importance of Cairo

Although the urban infrastructure is declining throughout Egypt, a deterioration in the quality of life is most evident in Cairo and Alexandria, according to the USAID Mission in Cairo. The decay in Cairo potentially has the most serious political consequences because the city is the center of national life. Nearly one-fourth of all Egyptians live in the greater Cairo area, and these residents tend to be better educated and to have higher expectations than rural Egyptians. President Mubarak's efforts over the past several months to begin the overhaul of Cairo's infrastructure and his requests for US help reflect the city's importance. Egyptian officials fear that frustrations over living conditions in Cairo could lead to unrest that might threaten the regime's survival. Disturbances elsewhere in Egypt are far less menacing.

The government faces an immense challenge, and we believe it will be extremely difficult to maintain, let alone improve, the quality of life in Cairo. Unless the city's population growth rate of 4 to 4.5 percent a year is slowed, the population of the greater Cairo urban area will double by the year 2000 from 10 million. Government efforts to stem growth, including attempts to create other urban centers, so far have failed to relieve the population pressure.

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Status of Public Services

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The provision of piped water varies widely within Cairo. About two-thirds of all buildings in the greater Cairo area are directly connected to the public water system. In some areas, however, particularly where housing has been built without government permits, buildings are not eligible for water connections and other public utilities. Residents in these areas depend on canals or public standpipes, where disputes often arise over water sharing. Water prices are estimated at 10 to 20 percent of operating costs and provide little incentive for conservation. Such low rates also produce insufficient revenue for upkeep—a particular necessity since sections of the water system date back to the beginning of this century. As a result, low pressure and service interruptions are common.

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Sanitary drainage poses as big a problem as water supply. Despite expansion efforts in recent years, parts of the greater Cairo area have no access to the public sewerage system, a situation that creates major health problems. Where the system is in operation, there are frequent leaks due to insuffi-

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27 May 1983

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cient capacity and maintenance. A recent study by the Cairo governorate stated bluntly that the sewerage system simply is unable to absorb the volume of Cairo waste water. According to a government sanitary official quoted in *al Ahram*, there are periodic leaks at more than 200 locations. []

Cairo lacks a municipal solid waste management system, and trash in the streets has been cited as the most significant source of frustration to Cairenes. In some central city areas, uncollected refuse at times reaches half a meter deep or more. Indeed, some streets are completely blocked by a combination of garbage and construction materials. There is no public responsibility for the collection of household and business waste. This is left to the free market, primarily to a community of garbage collectors, the zabbaleen. The zabbaleen's donkey carts collect more than half of Cairo's trash, according to a recent World Bank study. They provide service primarily in middle and upper class neighborhoods. []

Electricity is the most extensively provided public service and is less a source of complaint. In the 1976 census, 77 percent of buildings were connected, and, according to a more recent survey by a US firm and the Egyptian Government, service has been steadily expanded since then. Not all are legal hookups, however, and many buildings simply tap into a neighbor's electrical source and help pay the bill. This contributes to breakdowns and occasional outages. Although household consumption is only 10 percent of national consumption, it has grown rapidly in recent years. Low electricity prices, rising incomes, and greater imports of consumer electronics allowed under Sadat's "open door" economic policy have helped fuel this growth. []

Street congestion in Cairo is one of the most visible of the city's problems. The parking problem in the central business district is caused by some 17,000 cars parked in an area with only 5,000 parking spaces, according to a recent World Bank study. Double and triple parking or parking on sidewalks disrupts the city's heavy vehicular and pedestrian traffic. []

Public transportation is straining to meet demand. A recent World Bank study indicates that 63 percent of all trips in Cairo are made by public transportation (buses and taxis), 23 percent by walking, and 14 percent by private cars and motorcycles. One-third of Cairo's 2,300 buses usually are out of service. Those operating are severely overloaded, leading to increased wear. Crowded streets cause low operating speeds and reduce efficiency. []

Institutional Obstacles

Cairo's current problems stem not only from population growth but also from government inefficiency and inertia. Tangled lines of authority and bureaucratic buckpassing are the norm in Egypt. Responsibility for public services is divided among several bureaucracies. The three governorates with local jurisdiction—Cairo, Giza, and Kalyubia—acknowledge little responsibility except for street construction, cleaning, and maintenance. Public services such as transportation, water, sewerage, and electricity are provided by other government agencies. []

The tendency toward bureaucratic proliferation was displayed in January when a new environmental agency was created to deal with problems affecting the quality of life. This new organization is supposed to serve as a link between the Prime Minister's office and the various ministries and other agencies that deal with public services. It is not yet clear whether the new organization will be given the funds or the responsibility to take action. At a minimum, however, it will provide another layer of bureaucracy that impedes rather than fosters action. []

Government subsidies have contributed to public service problems and constitute a major impediment to their resolution. Tariffs and fees bear little resemblance to actual investment and operating costs, which results in inadequate funds for maintenance. []

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27 May 1983

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nance and new investment. Sewerage services to those connected are free, and water tariffs are only 10 to 20 percent of the cost of supply, according to a recent World Bank study. Transportation fares and electricity rates—despite some recent increases—do not cover more than a fraction of operating costs. The Cairo Transport Authority has always run at a loss, and its management philosophy has become engrained with the mentality of subsidies, according to the same World Bank study.

The government has been very cautious about pricing issues. An extensive and costly system of price controls and subsidies has evolved over the years to protect Egyptian consumers from inflation. In the case of bread and other food subsidies, government policies are expensive but have succeeded in feeding poor Egyptians and maintaining stability. In the case of public services, however, the benefits of low prices are undermined by the poor quality of such services.

When price changes have occurred, they have been small. In the spring of 1982, electricity prices paid by household consumers and small businesses were increased by 5 to 20 percent. In anticipation of domestic complaints the hikes were made with little fanfare, and the public mood was closely monitored by security officials. The changes did not cause security problems, and this may indicate that the government has more latitude for raising utility rates than it thinks.

A further constraint on improvements in Cairo's public services has been the central government's efforts to direct urban spread to new settlements in the desert. While an attractive idea aimed at taking the pressure off Cairo, its promise has not been fulfilled. Progress on these new cities, such as Sadat City and Tenth of Ramadan, has proceeded slowly. In particular, they lack the jobs needed to lure residents. Private business and the government still prefer to invest in Cairo because, despite its problems, there is a wider range of services, labor, and sales outlets than in the new cities.

The Challenge Ahead

Cairo will remain the center of commerce in Egypt, but unless the government can provide a sound infrastructure, its efficiency as an urban center will decline. The productivity of the work force will continue to suffer because of the poor living environment. Perhaps more dangerous, however, is the prospect that the declining quality of life will provide a fertile breeding ground for antiregime opposition groups. Unless remedies are found, Islamic fundamentalists and leftists will attempt to cite deteriorating urban conditions as a major argument for changes in Egypt's leadership.

Egypt's Five-Year Plan for 1982/83 to 1986/87, which was approved by the People's Assembly in January 1983, supports Mubarak's goal of improving public services. A breakdown of investment for the plan indicates that 13 billion pounds (\$18 billion at the official exchange rate) in investment is earmarked for electricity, transportation, public utilities, and other public services throughout the country. A reflection of the government's changing priorities is the virtual phasing out of public housing investment, leaving it to the private sector. Although inadequate housing remains a problem, the government has realized that it should concentrate its limited resources on public services that are outside the scope of the private sector.

Achieving the goals of the five-year plan, however, will prove difficult, particularly given the decline in world oil prices. Petroleum provides one-fourth of Egypt's foreign earnings, and hard currency shortages probably will reduce imports needed to sustain economic growth. The five-year plan, moreover, assumes real economic growth of 8 percent per year throughout the period and a doubling of the domestic savings rate over the course of the plan. This fast growth and the increase in savings are expected to generate domestic resources for investment. The assumed 8-percent real growth already is being discounted by Egyptian officials, however, in discussions with US Embassy officials, and the increased savings rate is unrealistic as well.

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Shortfalls in the availability of resources for the five-year plan will not necessarily reduce Mubarak's desire to improve public service investments and maintenance in Cairo. Nonetheless, it will take a major leadership effort to maintain ambitious programs in Cairo while cutting back elsewhere. Should the government reduce efforts in Cairo, a further decline in services could well occur. For example, the National Urban Policy Study done in 1980 and 1981 for the Ministry of Development by US and Egyptian experts projected a needed investment of at least 12 billion pounds (\$17 billion at the official exchange rate) in the greater Cairo area alone during 1986-2000 to provide the growing population with minimum services and housing by the next century. Although these figures are not directly comparable to the five-year plan, they indicate the magnitude of future construction and needed repairs. The study assumed lowering existing quality standards and, similar to the five-year plan, was based on real economic growth of 7 percent, a sharp increase in domestic savings, and higher utility rates to recover costs and fund upkeep. All of these assumptions appear increasingly unattainable. [redacted]

Implications for the United States

US support for Egyptian efforts to improve domestic services in Cairo should have positive political payoffs. The Egyptian public is expecting President Mubarak to improve living conditions, and Egypt's leadership is looking to demonstrate visible benefits from Egypt's close relationship with the United States. Mubarak's personal requests for US aid to improve water and sewer service underscore the importance he gives to these issues. The US offer to allocate \$1.25 billion in aid funds over the next five years for water and sewer projects has been favorably received in Egypt. The next test will be the difficult process of moving from this commitment to concrete action. [redacted]

Improved public services should increase overall economic activity and help the investment climate, particularly for foreign investors. Difficulties in securing hookups to basic services and the overall problems of life in Cairo currently discourage these investors. US help in the public services area thus should have important spillover effects encouraging economic growth. [redacted]

Increased US involvement is not without risk. The Egyptian public is sensitive to foreign involvement and to any appearance of Egyptian dependence on other states. Opposition spokesmen will doubtless charge that US involvement in the rehabilitation of Cairo's public services gives Washington increased influence over Egypt's economy and the daily lives of Cairenes. A greater danger may lie in US identification with problems that arise as the upgrading of public services proceeds. If US-funded construction projects are delayed by bureaucratic obstacles, the risk of adverse criticism also would grow. Balanced against these risks, however, is the prospect that doing nothing to help meet Cairo's needs would be ignoring a major concern of Egypt's leaders and would also generate sharp criticism of the United States. [redacted]

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North Yemen: In a Financial Bind

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North Yemen has been living beyond its means for several years, as evidenced in recurring budget and balance-of-payments deficits. At recent rates of depletion, foreign asset holdings will be gone by the end of this year. Foreign aid has leveled off and worker remittances—Sanaa's main source of foreign exchange—probably have peaked. President Salih's economic problems are compounded by the reconstruction needs stemming from last December's devastating earthquake and by an extensive parallel economy based on smuggling and irreverence for the central government.

Only a large infusion of foreign aid can alleviate Salih's problems, but prospects for help are not good. Salih's economic development program is in jeopardy, and he probably will be forced to introduce strict austerity measures. Virtually any economic retrenchment or measures to raise additional revenue, however, risk social discontent and erosion of the regime's already narrow political base.

Structural Problems

North Yemen's economy suffers from several structural defects that complicate efforts to deal with the deteriorating economic situation. Much of the population lives beyond effective government control, outside of poorly developed communication and transportation arteries. The economy is based largely on subsistence agriculture. Few commercially exploitable minerals are known, and the search for oil has proved fruitless. Sanaa has the worst trade imbalance in the world, with export earnings typically covering less than 1 percent of the import bill.

Although substantial foreign exchange is received through worker remittances, these earnings have

distorted more than benefited the economy. A labor shortage was created in the 1970s by migration of about 700,000 Yemeni workers—half the domestic labor force—attracted by the economic boom in neighboring countries. The worker exodus generated demand for foreign labor to replace the loss of Yemenis, pushed up wage scales, and contributed to deterioration of the country's agricultural base.

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The migration also fostered the development of a black market. Increased purchasing power afforded by the wide distribution of worker remittances stimulated unbridled import growth. Government attempts to profit from the burgeoning consumer demand through imposition of customs duties on imports resulted in dependence on remittances as the largest source of foreign exchange and the chief source of revenue. At the same time imposition of customs duties, coupled with the government's inability to control border areas, stimulated trade in smuggled goods and illegal currency transactions. According to the US Embassy, the scope of black-market activity now siphons off substantial government revenues and denies it needed foreign exchange.

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Moreover, government hopes of channeling remittances into productive investment have been only marginally fulfilled. Because of political uncertainty about the outcome of the confrontation with the South Yemeni-supported insurgency, private investors have sought rapid returns from ventures in retail sales or production of light consumer goods and have shied away from investments involving long-term payoffs. The government has carried the burden of financing both the country's infrastructure and the infant industrial sector with little help

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DI IEEW 83-021
27 May 1983

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North Yemen: Balance of Payments ^a

Million US \$

	1976/77	1977/78	1978/79	1979/80	1980	1981	1982 ^b
Trade balance	-619	-794	-1,247	-1,539	-1,902	-1,737	-967
Exports (f.o.b.)	19	7	3	7	13	11	NEGL
Imports (f.o.b.)	638	801	1,250	1,546	1,915	1,748	967
Net services	-56	-69	-36	0	-21	-51	-78
Government ^c	16	24	58	135	106	32	NA
Private	-72	-93	-94	-135	-127	-83	NA
Unrequited transfers	922	1,140	1,145	1,211	1,232	1,126	778
Government receipts ^d	104	101	312	112	148	337	343
Private ^e	818	1,039	833	1,099	1,084	789	435
Receipts	935	1,312	1,243	1,360	1,341	988	574
Payments	-117	-273	-410	-261	-257	-199	-139
Current account	247	277	-138	-328	-691	-662	-267
Net capital	50	75	116	158	494	229	118
Drawing on loans	54	81	114	124	466	262	NA
Repayment of loans	-4	-6	-10	-7	-15	-58	NA
Investments			12	41	43	25	NA
Errors and omissions	150	11	182	24	49	103	21
Overall balance	447	363	160	-146	-148	-330	-128

^a Fiscal year. Fiscal year changed to coincide with calendar in 1980. Previously, fiscal year was July-June.

^b First six months.

^c Consists mainly of investment income from official reserves.

^d Cash grants and value of commodity grants.

^e Primarily workers' remittances.

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from private enterprise. As a consequence, the Yemeni industrial base is not sufficiently developed to stem the consumer-led growth in imports. []

1982 are incomplete, reserves were drawn down by \$400 million, suggesting a balance-of-payments deficit of the same magnitude. []

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Tightening Finances

Steady deterioration in North Yemen's financial situation has produced yearly budget deficits—over \$700 million last year. In the balance of payments, rising imports have outpaced the main sources of foreign exchange—grants, loans, and worker remittances—necessitating foreign reserve drawdowns to cover the difference. Although payments data for

Despite worsening economic trends, President Salih in 1982 launched a five-year plan, which targeted spending at \$6.5 billion based on groundless expectations that worker remittances would cover 33 percent of the costs and foreign aid 46 percent. Aside from the foreign exchange leakage into the black market, Salih ignored mounting evidence that remittances had peaked because of economic slowdowns in neighboring countries. He also failed

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North Yemen: Government Finances ^a

Million US \$

	1977/78	1978/79	1979/80	1980	1981	1982 ^b	1983 ^c
Revenues	533	783	714	826	1,066	1,190	1,215
Current ^d	442	483	614	678	729	856	NA
Grants	91	300	100	148	337	334	NA
Expenditures	537	992	1,116	1,527	1,569	1,900	1,938
Current	278	410	562	656	723	910	1,126
Capital	259	582	554	871	846	990	812
Deficit	-4	-209	-402	-701	-503	-710	-723
Financing of deficit	4	209	402	701	503	710	
External ^e	63	123	117	451	205	265	
Domestic ^f	-59	86	285	250	298	445	

^a Fiscal year. Fiscal year changed to coincide with calendar in 1980. Previously, fiscal year was July-June.

^b Provisional.

^c Budgeted.

^d Includes taxes and nontax sources.

^e Project and commodity loans, minus repayments.

^f Includes Central Bank, commercial banks, and statistical adjustment.

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to anticipate that falling oil revenues would reduce foreign aid commitments from the Gulf Arabs. The Yemenis unrealistically expected to receive about \$100 million annually from the Arab Development Decade Fund but now probably will not even receive a \$70 million loan agreed to in 1982. They had also banked on a \$400 million loan from Iraq that Baghdad clearly had little capability to deliver. Sanaa's most important benefactor, Saudi Arabia, typically gives about \$200 million annually for budget support and project development and larger sums during military confrontations with South Yemen. Given current Saudi revenue problems, however, we believe Riyadh is unlikely to increase aid in the absence of another insurgent threat against North Yemen or the prospect of an outright economic collapse. [redacted]

Relief from North Yemen's deteriorating economic situation was made even more remote by a devastating earthquake last December which left 300,000 people homeless and caused an estimated \$2 billion in damage to housing, schools, and

infrastructure. Appeals for foreign assistance garnered only about \$50 million—\$30 million from Saudi Arabia—prompting the Yemenis to make further appeals for Saudi aid. [redacted]

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Crunch of 1983

The stark reality now facing the Yemenis is a financial gap of \$1 billion for fiscal 1983, up from their initial forecast of \$720 million. Meanwhile, foreign reserves have fallen to \$500 million from a peak of \$1.6 billion in early 1979. To cope, the government largely abandoned its budget—withholding funds from some ministries. The US Embassy in March reported that mandatory "contributions" had been deducted from civilian and military personnel salaries, ostensibly for earthquake relief and support of Palestinian refugees, and that some government salary payments were three months late. [redacted] restrictions have been placed on imports and hard currency transactions. [redacted]

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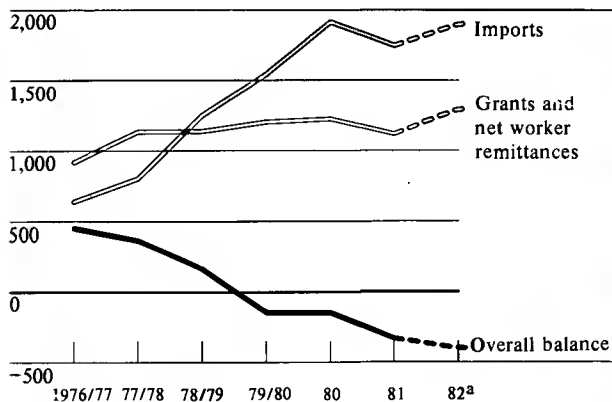
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North Yemen: Selected Foreign Economic Indicators

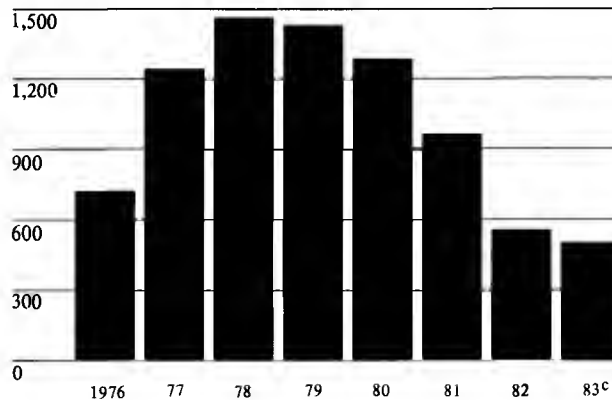
Note change in scales

Balance-of-Payments Determinants
Million US \$

^a Estimated.^b End of year.^c February 1983.

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Official Foreign Assets^b
Million US \$



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Further cuts in spending will have to be made. Social programs such as medical care and education probably will bear the brunt of the cuts because most development funding is earmarked for capital investment, which is externally financed and tied to specific projects. New project starts also will decline unless they are already funded.

Sanaa has not yet requested financial support from the IMF, although the IMF reportedly has laid out conditions that North Yemen must meet if it is to qualify for large-scale loans. These include institution of a strict program to reduce government expenses, devaluing the Yemeni rial, and improving collection of taxes and customs duties.

Sanaa will have to curtail budget outlays in any event but will be reluctant to adopt the other conditions for fear of alienating the populace. Devaluation would boost prices and is staunchly

opposed by the business community that deals in legal imports. Increased customs duties would divert even more trade to smugglers and probably result in lower revenues for the government. The government's ability to enforce tax collection traditionally has been weak; increased collection efforts probably would have to be focused on government employees, the military, and highly visible companies. Small businessmen, traders, and the population outside of main cities could likely evade payment.

Lack of resources forced the government to make two basic decisions about repair of earthquake damage: (a) the cost of reconstructing housing (the major loss) will be borne by the householders themselves, and (b) the government will only restore public services (water, electricity, clinics) to the level existing before the earthquake rather than try to upgrade them.

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Outlook

President Salih is caught essentially in a no-win situation. He cannot count on increased foreign aid, and traditional economic prescriptions for the ailing economy risk serious erosion of his political support. For the most part, North Yemen's economic problems demand long-term solutions. The country needs to reduce its import bill by developing productive capacity in agriculture and domestic industries. For this the government will have to nurture confidence in the private sector. In view of the chronic political instability, traditional Yemeni aversion to government authority, and the propensity to opt for quick investment returns, progress on this front will be slow. []

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A serious attempt to stifle smuggling would require deploying troops to the northern border. Even if this did not upset the Saudis, it would antagonize the area's powerful tribes, who have the capability to resist militarily. Moreover, the economic livelihood derived from black-market activity will make its participants inclined not to cooperate. []

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Earthquake victims constitute an additional problem. Economic atrophy and political alienation within affected areas will be the consequence of prolonged delays in building shelters or restoring rudimentary public services. []

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Given the difficulty of these problems and the few levers in Salih's hands, the prognosis over the next year is a deepening of popular disaffection with his government's performance and a corresponding growth in government repression and reliance on the military to protect the regime. []

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USSR and Eastern Europe: Early Grain Crop Prospects

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Both the Soviet Union and Eastern Europe appear headed for good grain crops this year. Continued favorable weather could result in a 220-million-ton harvest in the USSR, while the East European crop could reach 96-100 million tons—only slightly below last year's record. Neither region, however, has much chance of reaching planned targets of 238 million tons for the USSR and 112 million tons for Eastern Europe.

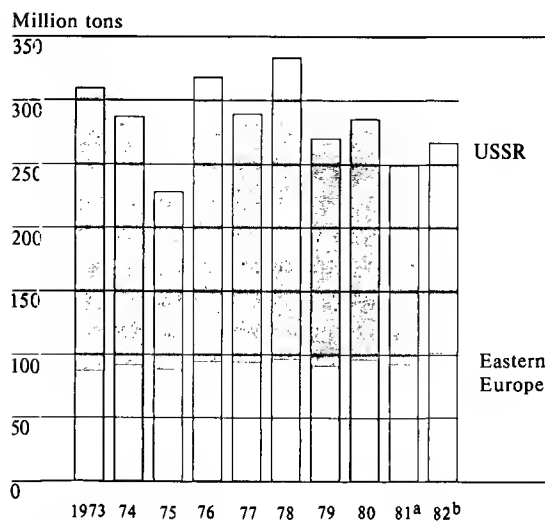
one-third of total Soviet grain output—will probably fall short of the 60 million tons averaged during 1978-82. Spring grains are off to a good start, however, and if good weather continues, total grain production could still reach 220 million tons. A crop of that size could allow the USSR to begin making headway on improving food supplies and reducing dependence on Western grain—two long-standing goals reaffirmed by the new leadership.

USSR

Because of problems already encountered, Soviet winter grain production—which accounts for about

According to information available through mid-May, winter grain production this year probably will be somewhat below average, reflecting a reduction in the sown area and prolonged unfavorable growing conditions in several key regions. We estimate that winter grains were sown on only 32.5 million hectares, an area around 10 percent below plan and one of the smallest sown areas recorded in the past decade. Planting was inhibited by near-drought conditions last fall in parts of the southern Ukraine, the North Caucasus, and the lower Volga Valley, areas that typically produce about 30 percent of the winter grain crop. Moreover, because of inadequate soil moisture, seed germination and prewinter plant development were poor. Crop prospects are better in the winter rye areas to the north because sowing occurred on time and soil moisture levels have remained adequate.

USSR and Eastern Europe: Grain Production



^a Data for USSR unofficial.

^b Estimated.

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We estimate that total losses of winter grains have reached about 15 percent of the sown area, normal for the USSR. Lack of moisture was chiefly responsible. The US agricultural counselor in Moscow reported sizable drought damage in the Ukraine, and

many winter grainfields in the southern European USSR emerged from dormancy in poor condition. Stands were thin, growth

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DI IEW 83-021
27 May 1983

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USSR: Winter Grains ^a

	1978	1979	1980	1981	1982	1983
Area						
Sown (million hectares)	36.9	33.0	36.9	34.0	35.5	32.5 ^b
Harvested (million hectares)	32.2	26.5	32.6	29.3	31.9	27.5 ^b
Winterkill ^c (percent)	13	20	12	14	10	15 ^b
Production (million tons)	85.9	49.6	63.1	55.0 ^b	55.0 ^b	60.0 ^d

^a Winter wheat, rye, and barley.^b Estimated.^c Percent difference between sown and harvested area. Includes some acreage used for forage.^d Upward limit.

uneven, and many fields were being resown to spring grain. Three days of steady rain at the beginning of May brought considerable relief to the dry areas, but more precipitation is needed to replenish subsoil moisture. Even then, winter grain yields would be only slightly improved because much of the damage is irreversible.

Because of the expected shortfall in winter grain output, spring grains will play a larger-than-normal role in determining the size of the 1983 grain crop. Conditions are encouraging so far.

timely rainfall has resulted in initial plant development that is good to excellent. Spring arrived two to three weeks early, enabling the annual spring sowing campaign to get off to one of the fastest starts ever. Planting in the majority of the European USSR was completed ahead of schedule, decreasing the likelihood of crop damages from the summer's hottest weather. In the main spring wheat areas east of the Ural Mountains, sowing, as usual, got under way just recently. With more than one-third of the spring grains yet to be planted, however, it will be weeks before a defini-

tive forecast of 1983 grain production in the USSR can be made with confidence.

Implications for Grain Imports. The prospects for a continuing world grain glut will allow the USSR to delay import decisions until the size of its crop can accurately be determined. The head of the Soviet grain buying agency recently told grain traders that Moscow would be buying very little grain on the world market this summer. As a result, Moscow probably will repeat last summer's low level of grain imports—under 6 million tons—to keep internal transportation facilities free to handle the domestic harvest.

Eastern Europe

In contrast to the USSR, winter grains in Eastern Europe are off to a good start. This, combined with continued good growing conditions for spring grains, could result in a total harvest of 96-100 million tons. Eastern Europe desperately needs a good harvest because shortages of hard currency and the region's concern over indebtedness to the West have resulted in sharp cutbacks in grain imports. Even a crop equal to the 1982 record of 101 million tons will not prevent a further deterioration in food supplies for some countries in 1983.

Winter grain production, which provides about one-half of Eastern Europe's total output, could well exceed the 47-million-ton average. Warm, sunny weather last fall allowed farmers in most countries to complete sowing on time over a larger area than the year before, and adequate rainfall promoted fairly good plant development almost everywhere.

the crop was generally healthy as it approached dormancy. Furthermore, mild winter temperatures prevented major damage, and winterkill losses from a February cold spell in Poland and East Germany can be easily made up by reseeded.

In contrast to crops elsewhere in Eastern Europe, prospects for the winter grain crop of Poland are

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Eastern Europe: Grain Production ^a *Million tons*

	1983	1982	
	Plan	Plan	Production
Eastern Europe	111.6	104.4	101.3 ^b
Northern countries	42.5	40.7	41.5
Czechoslovakia	11.0	11.0	10.3
East Germany	10.3	10.0	10.0
Poland	21.2	19.7	21.2
Southern countries	69.1	63.7	59.8
Bulgaria	10.3	9.5	8.2 ^b
Hungary	14.5	14.2	14.7
Romania	25.3	24.0	19.5 ^b
Yugoslavia	19.0 ^b	16.0 ^b	17.4

^a Winter grains comprise 60 percent of total grain production in the northern countries and 40 percent in the southern countries.

^b Estimated.

[redacted]

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probably only average. An autumn drought kept the sown area 12 percent below plan and caused spotty germination and weak plant development. Although late fall and winter rainfall brought relief, Poland will need a good spring grain crop if it is to produce more than the 19-million-ton average of recent years. [redacted]

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With winter grains in good condition, favorable prospects for spring grains increase Eastern Europe's chances of achieving an above-average total grain harvest. Mild March weather allowed fieldwork and sowing operations to begin ahead of schedule in many areas. [redacted]

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[redacted] spring grains emerged well. Recent warm, dry weather in southeast Romania and Bulgaria has decreased soil moisture to barely adequate levels, however. Winter grain fields there have begun to show damage. Unless plentiful rain comes soon, grain yields there could be significantly reduced. [redacted]

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